



STATE OF WASHINGTON

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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September 6, 1996

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Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

RE: In the Matter of Accounting Safeguards Under the
Telecommunications Act of 1996
FCC 96-309; CC Docket No. 96-150

Dear Secretary:

Pursuant to FCC Rules, Sections 1.415 and 1.419, enclosed is the original and 18 copies of the Reply Comments of the Washington Utilities and Transportation Commission (including two copies marked "Extra Public Copy") regarding the above referenced matter.

Sincerely,

STEVE KING
Acting Secretary

Enclosures

For Office of the Secretary
List 7/10/96

0418



Before the
Federal Communications Commission
Washington, D.C. 20554

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In the Matter of)	
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Implementation of the)	
Telecommunications Act of 1996:)	CC Docket No. 96-150
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Accounting Safeguards Under the)	
Telecommunications Act of 1996)	

REPLY COMMENTS OF
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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I. INTRODUCTION AND SUMMARY

The Washington Utilities and Transportation Commission (Washington Commission or WUTC) submits the following reply comments in response to the Federal Communications Commission's (FCC) Notice of Proposed Rulemaking of July 18, 1996. The WUTC appreciates this opportunity to address the issues.

Generally, we agree with the use of accounting and structural safeguards for the purpose of protecting against cross subsidization and discouraging discrimination. However, these safeguards in and of themselves are not sufficient to prevent or to ensure against either of these problems. Accounting safeguards, as used in Parts 32 and 64, are a helpful tool in aiding the ratemaking process. These mechanisms are of limited effect however, unless they are scrutinized by a regulatory body and the necessary adjustments are made, where appropriate. To separate non-regulated from regulated costs in this fashion (Part 64) often leaves residual costs with the regulated ratepayers by default.

As an additional measure, it may be helpful to ensure that the non-regulated services cover their respective costs (including contribution toward joint and common costs). This will greatly diminish the risk of cross subsidy. To this extent

we strongly agree with the initial comments of California¹ and New York², that Parts 32 and 64 with some modifications are good starting points. The FCC rules, however, should not limit the states ability to review and/or adjust cost allocations where necessary. We do not agree with the FCC's conclusion that §§ 271 and 272 expand federal authority over intrastate matters.

II. COMMENTS

A. Scope of the FCC's Authority (§ 43 et seq.)

The Washington Commission disagrees with the FCC's tentative conclusion in the NPRM that §§271 and 272 take precedence over §152(b) of the Communications Act and confer jurisdiction on the FCC as to intrastate matters. The FCC's argument is based in part on the premise that the MFJ³ reallocated state jurisdictional authority and that §§ 271 and 272, in replacing the MFJ, have the same limiting effect on the state role. The premise is flawed. The MFJ contained only limited restrictions on state authority. While it was in effect, the states continued to have jurisdiction over all intrastate operations of companies that were

¹ Comments of the People of the State of California and the Public Utilities Commission of the State of California, Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket 96-150, filed August 23, 1996, at pages 6 and 7.

²Comments of the New York State Department of Public Service, Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket 96-150, filed August 23, 1996, at page 8.

³*United States v. AT&T*, 552 F. Supp. 131 (DDC 1982)(subsequent history omitted).

not prohibited by the MFJ, pursuant to §152(b). The FCC's argument also erroneously misinterprets the legislative history. The fact that both the House and Senate removed from pre-conference versions of the bill provisions which explicitly exempted various sections of the bill from §152(b), including the precursors to §§ 271 and 272, is a clear indication of Congressional intent to preserve state jurisdiction over intrastate matters in this area. The FCC's dismissal of this legislative history is not persuasive. Section 601(c) of the 1996 Act underlines Congress' desire that the Act not be read so broadly as to create implicit changes in the law where none were provided for explicitly. Neither section 271 nor 272 contain any amendment to the jurisdictional assignment of intrastate matters to the states, and the Act must, therefore, be read to allow the states to retain their traditional authority in this area. This reading of the Act is consistent with §254(k), which recognizes the states' authority to adopt any necessary cost allocation rules for universal service purposes.

B. Accounting Safeguards

1. Non-Regulated Allocations (Part 64)

Cost allocation is not an exact science by any means. By definition, cost allocation is subjective and therefore should be carefully reviewed. The incentive exists, as the NPRM suggests (§ 6) for an incumbent local exchange carrier to misallocate the costs of its competitive ventures to its regulated core business, in order to shift costs onto captive ratepayers. Even if the rules are clear, there are

always exceptions, interpretations, and subjective determinations to be made. As new technology develops, the accounts or allocation factors used may become outdated. A recipe for cost allocation, therefore, is not the only thing that is needed. Although the FCC's current rules are helpful in identifying non-regulated services, the resulting cost attributions and allocations may not be sufficient in and of themselves to ensure against cross-subsidization or anti-competitive behavior. As we have found in Washington State, the only real way to be sure that a service is not being cross-subsidized is to ensure it covers its own costs. As we have found in the most recent U S WEST Communications rate case⁴, the average residential rate covers its incremental cost of service and provides a substantial contribution to U S WEST's shared and common costs.

The burden should be placed on the company to show that, if they provide non-regulated services and regulated services within the same company, the non-regulated services' prices must cover their respective costs. If the services are provided by a separate affiliate, there may be alternatives which are less burdensome. The FCC is addressing these in the Non-Accounting Safeguards NPRM, CC Docket 96-149. Although the state and federal regulatory bodies would not set the price (because of the non-regulated status), they should have the ability and authority to review the cost studies of non-regulated services to ensure they

⁴*WUTC v. USWC*, Docket UT-950200, Fifteenth Supplemental Order, pages 10 and 90 (April 1996).

cover cost. Part 64 is a cost attribution and allocation method which is helpful but not complete, absent active oversight and review.

2. Affiliated Interests and "Arms Length" Requirements (§§76-85)

In paragraphs 76 through 85, the FCC seeks comment on the methods that should be used to determine valuation of asset and service transfers between affiliates. In paragraph 78, the FCC proposes to require that affiliate transactions not involving tariffed assets or services be recorded at the higher of cost or fair market value if the carrier is the seller or transferor, and at the lower of cost or market if the carrier is the buyer or transferee. The Washington Commission strongly endorses this proposed requirement as an important safeguard. Our experience in the recent US WEST rate proceeding demonstrated that the company had purchased services from an affiliate at prices which exceeded those available to it on the open market for similar services, and had included the excessive costs in its rate proposal.⁵ The Washington UTC concluded that it should "look to the lower of the affiliate's cost or the market price for comparable services" to determine the allowable expenses for rate recovery. In that case, the Washington Commission looked to price information provided to the company by other vendors for use in a company-produced value study. We observe that even though the company had produced a study showing that its affiliate's prices were higher than those otherwise available to it, it did not have the incentive to purchase the lower

⁵*Id.*, pp. 52-55, attached as Appendix A to these comments.

priced services from a non-affiliate when the services could be purchased from an affiliate, albeit at a higher price. We therefore believe that the "good faith determination" requirement proposed in paragraph 83 is a good first step, but cannot by itself ensure that affiliates' transactions with BOCs will be conducted on an arm's length basis. Therefore we reiterate our belief that continued state scrutiny of BOCs' transactions with affiliates is a necessary component of oversight to ensure that rates for regulated services are set appropriately.

In reference to III.B.1.e., "Application to Joint Marketing", in paragraph 91, the FCC seeks comment on whether it should apply its cost allocation and affiliate transactions rules, modified as proposed in this Notice, to any joint marketing of interLATA and local exchange services, and whether additional accounting safeguards may be necessary.

In many instances, costs are accumulated in the regulated accounts of the local exchange company before allocations to affiliates or to nonregulated accounts occur. Thus, any underallocations of costs, or failures to review costs for possible allocation to affiliates or to nonregulated accounts, will result in excessive costs remaining in the regulated accounts on the local exchange company's books. This danger exists even under the cost allocation and affiliate transactions rules in effect today. One safeguard that could be added to those in effect, and proposed in the FCC Notice, would be to require that the shared marketing personnel be employed by and paid by the affiliate, and that costs be allocated to the BOC based on time records or other auditable documentation maintained by the shared personnel.

Using this approach, errors of omission would not result in overcharges to the BOC's local exchange services.

III. CONCLUSION


The Washington Utilities and Transportation Commission urges the FCC to adopt rules which facilitate the review of cost attribution and allocation between regulated and non-regulated operations. The Commission believes that the FCC's rules will act as helpful tools as State Commissions review rate increase requests and complaints of anticompetitive behavior. We caution the FCC not to overly rely on the tools themselves, but to work cooperatively with the State Commissions to enable them to use these tools in their discretion as they carry out their mutual responsibilities.

The Washington UTC looks forward to further participation and further opportunity to comment on these matters before the FCC.

DATED this 6th day of September, 1996, at Olympia, Washington.



SHARON L. NELSON, Chairman
Washington Utilities and Transportation
Commission



RICHARD HEMSTAD, Commissioner
Washington Utilities and Transportation
Commission

Before the
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CC 96-150

CERTIFICATE OF SERVICE

I certify under penalty or perjury under the laws of the State of Washington that on September 6, 1996, I served true and correct copies of Reply Comments of Washington Utilities and Transportation Commission and this Certificate of Service on the following persons as set forth on the attached list via Federal Express Overnight Mail:

See attached list

Dated and signed at Olympia, Washington, on September 6, 1996

A handwritten signature in cursive script, reading "Katherine Hunter", written over a horizontal dashed line.

Katherine Hunter

:44:28 06 SEP 1996

Parties UT-960330/FCC 96-309/CC 96-150

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